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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, OCTOBER 16, 2002

APPLICATION OF

VIRGINIA ELECTRIC AND
POWER COMPANY

CASE NO. PUE-2002-00377

To revise its fuel factor
pursuant to Va. Code §56-249.6

ORDER ESTABLISHING 2003 FUEL FACTOR

On July 1, 2002, Virginia Electric and Power Company ("Virginia Power" or "Company") filed with the State Corporation Commission ("Commission") its application, written testimony, and exhibits requesting a decrease in its fuel factor from 1.613¢ per kWh to 1.576¢ per kWh effective with usage on or after January 1, 2003, which results in a decrease in annual fuel revenues of approximately \$21.7 million. Concurrently, and by motion dated July 1, 2002, the Company also requested that the Commission enter a protective order governing the treatment of confidential information in the Company's fuel factor proceeding.

By Order dated July 16, 2002, the Commission established a procedural schedule, required notice of the application, and set a public hearing date for this matter. In the July 16, 2002, Order, the Commission directed its Staff to file testimony and provided an opportunity for any person desiring to participate

in the hearing to do so. The Virginia Committee for Fair Utility Rates ("VCFUR"), the Apartment and Office Building Association of Metropolitan Washington ("AOBA"), Chaparral (Virginia), Inc. ("Chaparral"), and the Division of Consumer Counsel, Office of the Attorney General ("Consumer Counsel") filed notices of participation as respondents in the case. VCFUR filed direct testimony and exhibits on August 4, 2002.

On July 26, 2002, the Commission issued its Order on Motion for Protective Order granting the Company's motion for a protective order with additional modifications proposed by the Commission Staff ("Staff").

On September 12, 2002, Staff filed its testimony. Staff recommended that Virginia Power's proposed estimate of energy sales and fuel prices used in the development of the proposed fuel factor be accepted as reasonable.

On September 16, 2002, the Company filed a letter with the Commission updating the estimated fuel expenses for the months of June, July, and August 2002, and changing the Company's under-recovery balance to \$45,829,329 and changing the proposed prior period factor from \$0.00028/kWh to \$0.00078/kWh. In addition, the Company's letter acknowledged that since no increase in the current total fuel factor of \$0.01613 was noticed, the Company's change to the proposed prior period

factor was limited to \$0.00065/kWh in the case. On September 19, 2002, the Company filed its rebuttal testimony.

The hearing to receive evidence on the fuel factor issues was convened on September 25, 2002. Appearances were made by counsel for the Staff, DVP, VCFUR, Chaparral, and Consumer Counsel. Testimony was received from Mr. Kurt W. Swanson, Mr. Charles A. Stadelmeier, Mr. William R. Eckroade, Mr. Harrison H. Barker, Mr. Gregory J. Morgan, and Mr. Andrew J. Evans for DVP; Mr. Ali Al-Jabir for VCFUR; and Mr. Michael W. Martin, Mr. David R. Eichenlaub, Mr. Lawrence T. Oliver, and Mr. Thomas E. Lamm for the Staff.

Parties agreed to stipulate as to the testimonies of DVP's witnesses Swanson, Stadelmeier, Eckroade, and Barker, and Staff witnesses Martin and Eichenlaub.

VCFUR Witness Al-Jabir testified that the Commission should fix the Company's fuel factor beyond 2003 through July 1, 2007, and defer the Company's recovery of a portion of the energy charges associated with certain power purchases made by DVP as a result of the Company's March 25, 2002, Request for Proposals. Staff Witness Lamm testified that there were many complexities raised by the issue of the fuel factor treatment of DVP's firm energy purchases. Witness Lamm indicated that the Staff was not prepared to propose a final resolution as to the fuel factor treatment. In addition, Staff Witness Lamm noted that these

issues merited additional study by the Staff, and that Staff would make recommendations before or during DVP's next fuel factor proceeding. Staff Witness Oliver testified concerning the continuation of a prior study by the Staff, requested by the Commission in DVP's most recent fuel factor case, of the Company's wholesale sales, off-system sales, out-of-system sales, option trading, and other related activities. Witness Oliver testified that he had not participated in Staff's study of DVP's wholesale trading practices and he had no recommendation relative to the amount of money that ratepayers received as a credit to fuel expenses from off-system sales relative to how much money shareholders received from off-system sales.

Finally, DVP rebuttal witnesses Morgan and Evans testified in response to the concerns raised by both Staff and VCFUR witnesses regarding appropriateness of certain firm energy purchases DVP entered into primarily for the summer months of 2002. DVP rebuttal witness Morgan testified that DVP's decision to purchase the energy was reasonable given the information available to the Company at that time, and that the component pricing structures agreed to by the Company with their counterparties were fully consistent with the market and were fair to ratepayers. DVP rebuttal witness Evans testified that the Company's purchase of the energy under the contracts was

necessitated by DVP's need for peaking capacity for the summer to meet its reserve margin. Witness Evans further testified that the energy purchased by DVP under the contracts was purchased as economy energy displacing higher-cost Company generation.

NOW THE COMMISSION, upon consideration of the record and the applicable law, is of the opinion that the Company's fuel factor shall remain at 1.613¢ per kWh effective with usage on and after January 1, 2003. We will also require continued Staff study relating to the appropriate allocation of the net proceeds that arise from the Company's participation in wholesale power markets. Further, we will require Staff to investigate issues surrounding the appropriate recovery in the fuel factor of costs incurred by the Company for power purchased pursuant to its March 25, 2002, request for proposals ("purchase power RFP contracts") as well as similar resource acquisition expenditures should they arise in the future.

As noted above, we will allow DVP to continue its fuel factor charge at the current level. As such, we decline to adopt the recommendation of VCFUR witness Al-Jabir to defer a portion of the charges associated with the recovery of the purchase power RFP contracts until such time as the above-mentioned study is completed. Nor will we adopt a "fixed" fuel factor as advocated by Mr. Al-Jabir. The instant proceeding did

not encompass the notice required by § 56-249.6 prior to dispensing with the adjustable fuel factor. We note, however, that such a fixed fuel factor may have certain merits, including increased judicial economies, changed incentives on the part of DVP, and increased electricity cost certainty for customers during the freeze period. As such, we remain open to proposals of this nature.

In addition, Staff seeks to continue study of the appropriateness of the mechanism by which net proceeds of DVP's wholesale trading activities are shared with ratepayers. Staff recommends further study noting that it has yet to complete a report as directed by the Commission in a prior DVP fuel factor proceeding (Case No. PUE-2000-00585). Staff notes that personnel changes as well as the complexity of the issue has thus far delayed Staff's report. We will allow Staff to continue its efforts in this area.

Finally, we require the aforementioned investigation and study of the Company's purchase power RFP contracts. The bulk of the contracts in question may be characterized as base loaded capacity resources, at least during the term of the respective contracts. DVP proposes to collect 94% of the contracts' costs through the fuel factor with the remaining 6% assumed to be collected via the Company's base rates. Both Staff and the

VCFUR believe that this 94%/6% fuel/capacity split allows DVP to recover non-fuel expenses in the fuel clause.

Staff and VCFUR both recommend further study of the issue. Staff recommends no adjustment at this time, while VCFUR recommends that \$13.4 million of recovery be deferred until the Commission makes a final determination as to the proper energy component of these contracts. DVP maintains that it has appropriately quantified energy and capacity costs associated with the purchase power RFP contracts. The Company argues that their inclusion of virtually all of the contracts' costs in the fuel factor is appropriate based on current and expected near term energy and capacity market prices.

DVP's actions in administering its March 25, 2002, solicitation and closing these transactions have not been challenged. In fact, these actions appear to have been well executed producing a minimum fuel factor given the feasible generation resource choices available to DVP in the spring of 2002. Given those choices, the Company appears to have made a reasonable decision to enter into the transactions at issue in this proceeding.

While the Company's decision to enter into the purchase power RFP contracts may not be at issue, the proportion of the contracts' cost proposed to be collected via the fuel factor remains in question. DVP has proposed one method to effect that

split; there may be others. Modifications to that split, if any, subsequently adopted by the Commission may apply to the 2002 fuel period and to future fuel factors. Staff's study should consider alternative mechanisms that may be employed to allocate a portion of the costs of the purchase power RFP contracts, or similar types of arrangements, to the fuel factor. We expect that Staff will explore market based methods as well as methods that may reflect the construction cost of new capacity. We are also interested in the Company's efforts through time to optimize its system with the goal of minimizing the total cost of providing service pursuant to § 56-249.6. We stress that we are interested in the Company's optimization efforts here for the purpose of Staff's study herein of the fuel factor.

Accordingly, IT IS ORDERED THAT:

(1) The total fuel factor of 1.613¢ per kWh, effective for usage on and after January 1, 2003, established by Commission Order dated December 8, 2000, remains in effect.

(2) Staff shall study the appropriate recovery of the fuel costs associated with the purchase power RFP contracts entered into by DVP pursuant to its March 25, 2002, solicitation as described herein. The Company shall assist the Staff in this effort by making available relevant documents and personnel as

well as other assistance deemed necessary by Staff. The VCFUR may participate in the study.

(3) Staff shall continue its study of the Company's wholesale sales, off-system sales, out-of-system sales, options trading, and other related activities, and shall file a report detailing its findings and recommendations.

(4) This matter is continued generally.